Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In re:	)	
OPP Working Paper Number 35	)	CS Docket Nos. 98-82, 96-85
Horizontal Concentration in the Cable Television Industry: An Experimental Analysis	)	MM Docket Nos. 92-264, 94-150, 92-51, and 87-154
	)	MB Docket No. 02-70

COMMENTS OF RCN TELECOM SERVICES, INC.

L. Elise Dieterich
Kevin D. Minsky

Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W. Ste. 300
Washington, D.C. 20007
(202) 424-7500

Counsel to RCN Telecom Services, Inc.

July 18, 2002

I. Introduction

RCN Telecom Services, Inc. ("RCN"), as the nation's first and largest competitive broadband overbuilder and largest open video system ("OVS") provider, competes directly with incumbent cable operators in seven of the ten largest U.S. markets, and therefore, is a significant purchaser of video programming from program networks. Therefore, the impact of horizontal concentration of the incumbent cable operators on the availability and price paid to obtain video programming is of vital concern to RCN.

RCN believes several of the experiments conducted under OPP's auspices and reported in Working Paper No. 35 (the "Working Paper") confirm an empirical reality in the marketplace – *i.e.,* that incumbent cable operators' monopoly and monopsony power affects the ability of competing multichannel video programming distributors ("MVPDs") to obtain access to video programming at fair market prices. The Working Paper's conclusions further support RCN's concern that additional horizontal consolidation -- *e.g.*, in the pending AT&T-Comcast merger -- would adversely affect the price and availability of video programming, and, hence, MVPDs' ability to compete.

The Working Paper's conclusions should be used by the FCC in the ongoing cable ownership rulemaking proceeding[1] as support for retaining reasonable ownership limits, and in the AT&T-Comcast license transfer proceeding as support for imposing conditions requiring the merged entity to make available to competitors on non-discriminatory terms programming, including terrestrially-delivered programming, that AT&T-Comcast owns or controls. However,

[1] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, Commission's Cable Horizontal and Vertical Limits and Attribution Rules, Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy,* Further Notice of

as discussed below, there are several deficiencies in the Working Paper's underlying methodology that the FCC should take into account when utilizing its conclusions and/or data in these or other FCC proceedings.

II. The Lowest Average Economic Efficiency Occurs in the Market Where A Single Cable Provider Holds 51% of the Market

According to the Working Paper, the lowest average economic efficiency[2] occurs under the High/High market concentration – *i.e.*, where there is one large cable operator with 51% national market share and several smaller MVPDs.[3] The Working Paper concluded that an increase in the concentration of cable operators led to a reduction in economic efficiency.[4]

This conclusion is consistent with RCN's observations in the marketplace – *i.e.,* that large national cable operators holding substantial national market shares tend to use their market power to inhibit competing MVPDs' access to video programming, or increase the cost of such programming. RCN is particularly concerned that AT&T and Comcast, should the FCC permit their pending merger to proceed, will abuse their market power to limit or deny access to video programming to RCN and other MVPDs that compete with the merged entity or to increase prohibitively the cost of programming.

Proposed Rulemaking, FCC 01-263, CS Docket Nos. 98-82, 96-85, MM Docket Nos. 92-264, 94-150, 92-51, 87-154, 16 FCC Rcd 17312 (2001).

[2] Economic efficiency was defined by the Working Paper as "measur[ing] the extent to which society makes the best use of its scarce resources." According to the Working Paper, "a reduction in economic efficiency indicates that fewer or socially less desirable trades occurred in the more concentrated market structure than in the less concentrated market structure. By sending the wrong price signals regarding the value society places on particular types of programming offered by programming networks, a reduction in market efficiency could affect both the type and quality of television programming received by viewers." Working Paper at 4.

[3] Working Paper at 27.

[4] Working Paper at 28.

The Working Paper's conclusion regarding market efficiency is also consistent with general antitrust law principles in that as a cable operator gains national market share – in addition to the monopolies it often has in each local market where it has the sole cable franchise – the large cable operator has an increased ability to use its bargaining power to adversely impact its competitors. In this case, large cable operators can use their market power to increase the affiliate fees competing MVPDs pay to programming networks.

III. A Cable Operator's Bargaining Power Can Impede Competing MVPDs' Access to Video Programming

Although the Working Paper concluded that an average cable operator's bargaining power[5] is not related to the level of horizontal concentration of cable operators in the market – *i.e.*, the bargaining power of a cable operator serving 27% of the MVPD market does not differ substantially from the bargaining power of a cable operator serving 51% of the MVPD market – this conclusion, however, likely resulted from the small number of cable operators assumed in the experiment, and the fact that even at 27%, an operator has significant bargaining power in the market.[6] Even at 27% of the market, the Working Paper concluded that a cable operator has a detrimental affect on the bargaining power of DBS providers and is likely to "cause the DBS provider to pay higher affiliate fees to cable networks."[7]

This conclusion should greatly concern the FCC, because it is not only indicative of the problems to be faced by DBS providers, who were assumed in the Working Paper to have

---

[5] Bargaining power was measured "as the percentage of total surplus (i.e., gains from trade) captured by a buyer when completing a trade with a seller." Working Paper at 4, 33.

[6] Working Paper at 33.

[7] Working Paper at 34.

approximately a 17% market share, but it also is illustrative of how smaller cable operators – including competitive broadband overbuilders and OVS providers, like RCN – will fare in an increasingly concentrated market. As horizontal market concentration among the largest cable operator increases, small MVPDs will end up paying higher affiliate fees to programming networks than their very large competitors, because the large operators can negotiate ever greater volume discounts. Moreover, the incremental cost to large MVPDs of paying a per-subscriber premium in exchange for exclusive rights to carry the programming becomes ever smaller.[8]

IV. Large Cable Operators' Ability to Impose a Most-Favored Nation Provision on Programming Networks Hurts Competing Providers

The Working Paper concludes that another detrimental affect of high horizontal market concentration among incumbent cable operators is their ability "to negotiate lower affiliate fees (per subscriber) than smaller buyers (i.e., cable operators and DBS providers)" in negotiations with popular programming networks through the use of a most favored nation ("MFN") clause.[9] The MFN clause ensures that its user, in this case a large cable operator, will not pay an affiliate fee to a programming network that is higher than the fee paid by another MVPD. As demonstrated in this experiment, large cable operators benefited the most through the use of a MFN, by paying the lowest affiliate fees as compared to their smaller competitors.[10] Therefore, this data again supports RCN's concern that large cable operators have an unwarranted

---

[8] For example, if programming costs $.25 per subscriber, and a large MVPD has 10 million subscribers, it need pay only a $.0025 per subscriber premium to make the programming provider whole, in exchange for an exclusive arrangement that would prohibit the sale of that programming to an overbuilder competitor with 100,000 subscribers in the large operator's territory.

[9] Working Paper at 5.

[10] Working Paper at 5.

advantage versus their smaller MVPD competitors, and that the FCC needs to maintain close oversight over large cable operators in order to prevent market power abuses.

V. The FCC Should Take Into Account the Shortcomings in the Working Paper's Assumptions and Methodology Should its Conclusions Be Used in Other FCC Proceedings

There are several potentially significant flaws in the Working Paper's methodology that arguably undercut the relevance of its conclusions to the real-world interactions between MVPDs and programming networks. These flaws should be taken into account should the FCC use the Working Paper's conclusions and/or data in other FCC proceedings. First, the experiment did not take into account that, in the real world, many large cable operators are themselves programming providers and/or have significant ownership interests in programming networks, a factor that obviously could affect the affiliate fees that the "owner" cable operators pay the programming network versus the rate paid by a competing MVPD, or whether the competing MVPD can obtain the programming at all.[11] Absent FCC-imposed constraints, cable operators, through their control of affiliated programming networks, can refuse to sell selected programs to competing MVPDs (as is currently occurring with certain terrestrially-delivered programming) or can manipulate the price, terms, and conditions on which affiliated programming is made available to competing providers.

Second, the number of sellers of video programming assumed in the experiment was extremely small – only four – and does not in any way approximate the number of programming networks in the real world.[12] By having a small number of programming networks rather than a

---

[11] Working Paper at 3.

[12] Working Paper at 3 n.6.

larger sample more reflective of the real world, the negotiating power of each in the experiment likely was artificially inflated. In the real market, where dozens of small programming networks compete for carriage and viewers, their actual bargaining power (and hence the affiliate fees received from large MVPDs and the programmers' ability to resist anti-competitive demands by their largest customers) is likely even smaller than the Working Paper suggests.

Third, other conditions imposed on the participants in the experiments were unrealistic. For example, buyers and sellers were not permitted to talk with one another; they merely exchanged bids electronically via computer terminals.[13] Moreover, the only item they discussed in the negotiations was the affiliate fee; in reality, other issues, such as advertising and promotion allowances and non-compete clauses, can arise in such negotiations, that would affect the outcome. Also, the human subjects recruited to play buyers and sellers in the experiment were not representatives from the cable operator and video programming provider industries, but rather undergraduate and graduate students asked to participate in the study, who had no apparent industry expertise.

VI. Conclusion

The data from the Working Paper, although perhaps not fully reflective of realities of the detrimental effects on competition resulting from a highly concentrated cable marketplace, nonetheless support definitive action by the FCC to retain appropriate cable ownership limits and to impose program access requirements as a condition of approval of the pending applications of AT&T Broadband and Comcast Corporation to transfer their licenses to the merged AT&T-Comcast. The experiments reported in the Working Paper show that, absent necessary

---

[13] For the conditions discussed in this paragraph, *see* Working Paper at 9-14.

regulatory constraints on the largest cable operators' disproportionate market power, the interests of programmers, cable competitors, and consumers will be harmed.

Respectfully submitted,

s/

L. Elise Dieterich
Kevin D. Minsky
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Ste. 300
Washington, D.C. 20007
(202) 424-7500

Counsel to RCN Telecom Services, Inc.

Date: July 18, 2002